JILL BACHUS

Jill Bachus Heading State Retirement System

By TIM MADDOX

When Jill Bachus assumed the role of executive director of the state's retirement system, the Tennessee Consolidated Retirement System (TCRS), in 2005 she took on the responsibility of helping manage the nearly 250,000 members currently enrolled in a system that pays out in excess of $1.5 billion a year in benefits.

The certified public accountant is head of TCRS, which was created four decades ago by the General Assembly to provide retirement benefits for public employees, including many local government entities, statewide.

TCN: Describe the membership of TCRS.

BACHUS: TCRS consist of four large groups of public employees, those being teachers, state employees, higher education employees, and local government employees where the local governing body has decided to provide coverage in the TCRS plan. More than 450 cities, counties, utility districts, emergency communication districts, special school districts, and other political subdivisions have opted to cover their employees in TCRS. There are more than 213,000 members consisting of 45,000 state employees, 73,000 teachers, 17,000 higher education employees, and 78,000 local government employees. Retirees total 110,000 and receive annual benefits exceeding $1.5 billion. The pension plan has asset of more than $32 billion dollars.

TCN: We hear stories about funding problems in many other state pension plans. What is the funding status of TCRS?

BACHUS: The financial marketplace during the first decade of this century has not been as rewarding as the 80's and 90's thus placing the pension programs of several states in serious financial peril. In the last 10 years there have been two severe bear markets. At the bottom of the latest bear market in 2008 the domestic stock market had losses up to 40 percent and international stock market more than 40 percent. Moreover, interest rates are at historical lows with the federal funds rate being less than 25 basis points. It has been reported that pension plans in Kentucky and Illinois have sold assets to meet their pension obligations. Many states have seen their funded status drop sharply due to these market downturns as well as not properly funding the plans over the years.

TCRS has not been without its challenges during this difficult economic time. One of our challenges is that the losses TCRS did sustain in the down market will probably create increases in the contribution rates for participating state, local, and education employers participating in TCRS. In these challenging times for revenues, any increases in employer contributions will be difficult. This is true even for TCRS which is in much better economic health than almost all other plans.

It appears we are in a stronger financial position than many other state pension plans. There are several reasons as to why TCRS continues to be on sound financial footing. First, the benefits provided by TCRS are fair but modest. Some states provide more aggressive benefits and do not have sound benefit policies. For example, some states allow members to work full time and receive a full pension while other states allow members to retire on full benefits at an early age. Second, every Governor and every General Assembly since 1975 has fully funded TCRS at the actuarially recommended rate as determined by an independent actuarial firm. Many states only finance a portion of their actuarially required contributions. Third, Tennessee takes a conservative approach to financing its pension cost. TCRS uses an earnings assumption of 7.5 percent whereas some states use a higher assumption ranging anywhere from 7.75 percent to 8.5 percent. The higher the investment assumption used by a pension plan results in greater funding deficits during down markets. Fourth, TCRS attempts to control downside risk by utilizing a conservative investment strategy as opposed to many states that have a more aggressive strategy by investing as much as 75 percent of their portfolio in stocks.

TCRS has a long history of being strongly funded and does not have to adopt a more risky investment strategy. The more aggressive investment strategy utilized by many states is an attempt to finance a liberal benefit structure, to make up for a poorly funded status, or to lower employer contributions.

The TCRS plan is over 90% funded on an actuarial basis and is rated AAA by Standard and Poor's.

TCN: Describe the actuarial funding objective of TCRS.

BACHUS: First, one must recognize that the long term objective of funding a pension plan is that employee contributions, employer contributions, and investment earnings must equal the promised benefits: monthly retirement annuities, disability benefits, and death benefits.

With that being said, the objective of TCRS is to prefund pension benefits before an employee retires. TCRS is funded on an actuarially accrued basis unlike social security which is essentially on a pay-as-you-go basis. Actuarial funding entails accumulating sufficient assets so that promised benefits will be paid. By prefunding benefits before an employee retires, more than 50 percent of the cost of the benefit is provided by investment income.

An actuarial valuation is preformed every two years by an independent actuary to determine the appropriate employer contributions so that the system is financed on an actuarial sound basis. Overall, TCRS uses a conservative set of assumptions and a conservative actuarial methodology. The actuarial process is a rather mundane process that involves a detail analysis of the age, salary history, service credit earned, and benefits accrued for every active and retired member. Then based on past experience, projections are made as to when current members will retire, the value of the benefit that will be paid, and how long members will live after retirement. The result is that an employer contribution rate is determined so that the employer contributions along with employee contributions and investment earnings provide financing for the promised benefits.

In addition, every 10 years TCRS contracts with an independent actuarial firm to perform an actuarial audit. The objective of the audit is to confirm the actuarial assumptions and methodology used in the valuation, as well as to confirm the results. An actuarial audit was most recently performed on the July 1, 2009 actuarial valuation. TCRS was very pleased with the results of the audit.

TCN: What is the investment strategy of TCRS?

BACHUS: TCRS has a long term investment horizon and therefore has a long term investment strategy. It is the objective of TCRS to obtain a rate of return commensurate with the level of investment risk taken. TCRS attempts to control downside risk by investing in a diversified portfolio of stocks, bonds, and commercial real estate. Because of this diversification, it is important to note that no single stock, bond, or piece of real estate will cause any financial difficulty to TCRS. TCRS is more affected by movements in the market than by any individual security held in the portfolio. Due to the strong financial position of the pension program, the overall investment strategy is conservative with only approximately 50 percent of the portfolio invested in stocks.

The vast majority of the assets are invested internally by TCRS staff. There are 20 investment professionals on staff. Thirteen are Charter Financial Analysts, twelve have their MBAs, and the group averages over 15 years of investment experience. The cost to manage the assets of TCRS is a very economical 5 basis points. External management would most likely cost five to ten times more.

TCN: Describe the benefit objective of TCRS.

BACHUS: Using the three legged stool of retirement planning model, the benefit objective of TCRS is to provide a level of benefits so that a long term career employee can maintain their same standard of living after retirement by receiving a TCRS benefit, a social security benefit, and utilizing personal savings.

Bachus

For members working to age 65 with 35 or more years of service, the TCRS benefit and the social security benefit will allow one to enjoy the same standard of living after retirement as they enjoyed prior to retirement. Personal savings using a 401k, 457, 403b, IRA, etc. will enable one to retire at an earlier age such as age 62 where social security benefits are reduced.

TCN: There has been ongoing national debate relative to defined benefit plans versus defined contribution plans. Would you provide the pros and cons of these two different types of pension plans?

BACHUS: Under a defined benefit plan, benefits are determined by a mathematic formula typically using an average salary and years of service as an input into the formula. Generally, eligibility to retire is based on age, service, or a combination of the two. TCRS is an example of a defined benefit plan. Under a defined contribution plan, benefits are ultimately the annuity value of the contributions made by the employee and the employer, as well as investment earnings. Examples of these types of plans include 401k, 457, 403b, IRA, etc.

Both plans have their advantages and disadvantages. First, I'll address the plans from an employer standpoint and then from an employee standpoint.

The most significant advantage of a defined contribution plan is the stability of the employer contribution rate which is usually set at a certain percentage of salary. There is more fluctuation of the employer contribution rate in a defined benefit plan because the rate is chiefly driven by volatility in the investment marketplace. During a booming market, rates tend to decline while slumping markets push the rates upward. The investment risk is borne by the employer in a defined benefit plan while it is borne by the employee in a defined contribution plan. Some employers prefer a defined benefit plan because it gives them an advantage to attract and retain employees. The cost of losing experienced employees, training new employees, worker compensation cost associated with inexperienced employees, and greater productivity are often arguments in favor of a defined benefit plan. Moreover, employees may put off retiring under a defined contribution plan and work beyond their productive years if account balances have not grown to a sufficient level to provide a reasonable standard of living.

Under a defined benefit plan, such as TCRS, employees can calculate a specific income replacement annuity that permits an employee to better target a date of retirement. Under a defined contribution plan, employees are not as readily able to establish a date of retirement and be assured of the level of benefits that are payable. Also, defined benefit plans typically provide a superior disability and death benefits.

Under a defined contribution plan, employees must be given considerable education about investing so as to make appropriate decisions about how to invest employee and employer contributions. If an employee is too conservative or too aggressive in their investment selection, then it could affect when an employee may be able to retire. Defined benefits plans may provide some type of cost of living adjustment after retirement whereas defined contribution plans typically do not.

On the other hand, defined contribution plans are more portable than defined benefit plans. Employees would have greater flexibility to change occupations and careers under a defined contribution plan. Defined contribution plans favor short term employees while defined benefit plans favor employees beginning employment with an employer later in life. Whether a career employee is benefited by a defined benefit plan or a defined contribution plan is dependent on a number of factors including investment choices, the investment marketplace, and employer and employee contributions.

TCN: Describe your background and experience.

BACHUS: I have been employed with the Treasury Department since 1981. I became director of TCRS in 2005 after serving as the assistant director for 6 years. I was also the director of accounting for the Treasury Department for 10 years. I am a CPA, have a Master of Business Administration degree from MTSU, and am a graduate of the Tennessee Government Executive Institute.

About The Tennessee Consolidated Retirement System

The TCRS was established as a retirement program for the many public employees of Tennessee. TCRS members are offered a wide variety of services including: counseling services to apprise members of their rights and benefits, access to informational materials and financial statements, processing deductions for retiree insurance programs and federal income tax, assistance calculating death, disability and retirement benefits and processing refund and prior service requests.

TCRS was created by the legislature in 1972 to provide retirement benefits for public employees throughout the state. Before consolidation, there were seven separate retirement systems for individuals working directly within state government or with the state's higher education institutions, public schools, or any participating political subdivisions of the state, i.e., local governments such as county and municipal governments.

Presently, TCRS is responsible for the pension benefits of all state employees and higher education employees. It also provides a sizable portion of the retirement liability for public school teachers through the Basic Education Program and the employees under the more than 450 participating political subdivisions of the state.

TCRS is a qualified pension plan under Section 401(a) of the Internal Revenue Code. As such, the system is exempt from federal income taxation on its investment earnings. Since January 1, 1987, member contributions are tax deferred. The 30-plus billion collective nest-egg that is TCRS is funded through employee and employer contributions and the earnings from investments.

While most of the actual investment decisions are made by full-time TCRS staff investors, final approval is subject to a board of trustees. Contribution rates from the various participating members of TCRS, and other such management decisions, are also determined by the Board. Of the 20 members of the Board nine are ex-officio members, nine are from the pool of members of the TCRS, and the final two are representatives for retirees.

Further input into how to meet the many requirements of TCRS is provided by several other governing entities: the Investment Committee which is appointed by the Board of Trustees, an Investment Advisory Council picked by the Board and the Treasurer, as well as the Council on Pensions and Insurance which is composed largely of members of the Senate and the House of Representatives.

Over the years, TCRS has earned some renown for its management and the growth and success of its fund. In 2009 it was awarded the Certificate of Achievement for Excellence in Finance Reporting for one its Comprehensive Annual Financial Reports. It was presented by the Government Finance Officers Association of the United State and Canada. The same year, it earned the Public Pension Standards Award for Funding and Administration from the Public Pension Coordinating Council.

CTAS Highway Training Series

More than 50 county highway officials recently met in Rutherford County for a "Legal Issues" training session offered by the County Technical Assistance Service and the Tennessee County Highway Officials Association (TCHOA). Part of the group included, from left, Claiborne County Hwy. Supt. Mike Sharp, Meigs County Hwy. Supt. Tim Jennings, Washington County Hwy. Supt. John Deakins Jr. and TCHOA Executive Director J. Rodney Carmical. The session is part of a series by CTAS targeting county highway officials.